

Revenue Royalties in China



principles, purposes, policies

Revenue Royalties in China

briefing by Asia-Pacific Group
to China Public-Private Partnership Council (CPPPC)
Beijing, September 2017

principles of operation
economic purpose
implementation policies

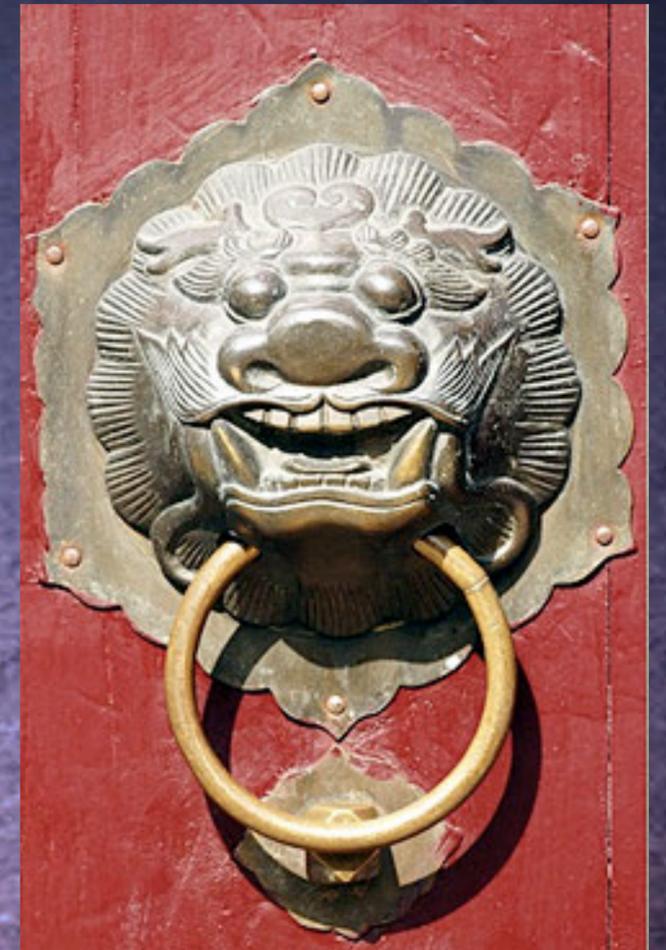
What are Revenue Royalties?

- A defined share of all revenues
- received by a company,
- for a specified time,
- in exchange for growth capital investment



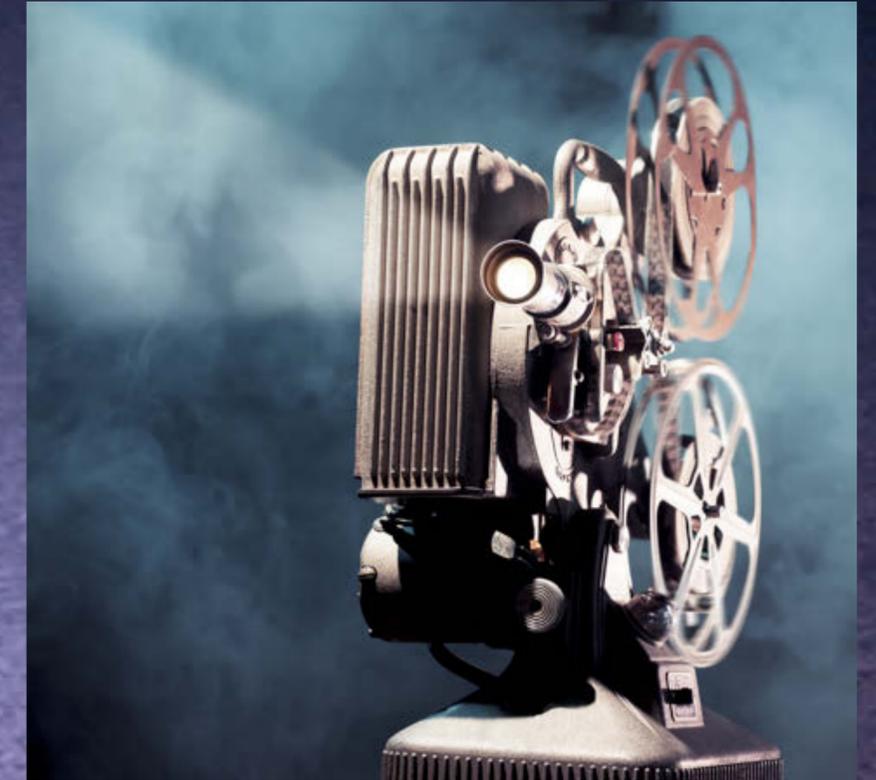
What are Revenue Royalties?

- An investment contract to receive a share of future revenues
- used to increase the future revenue generated by the company; for the benefit of all parties.

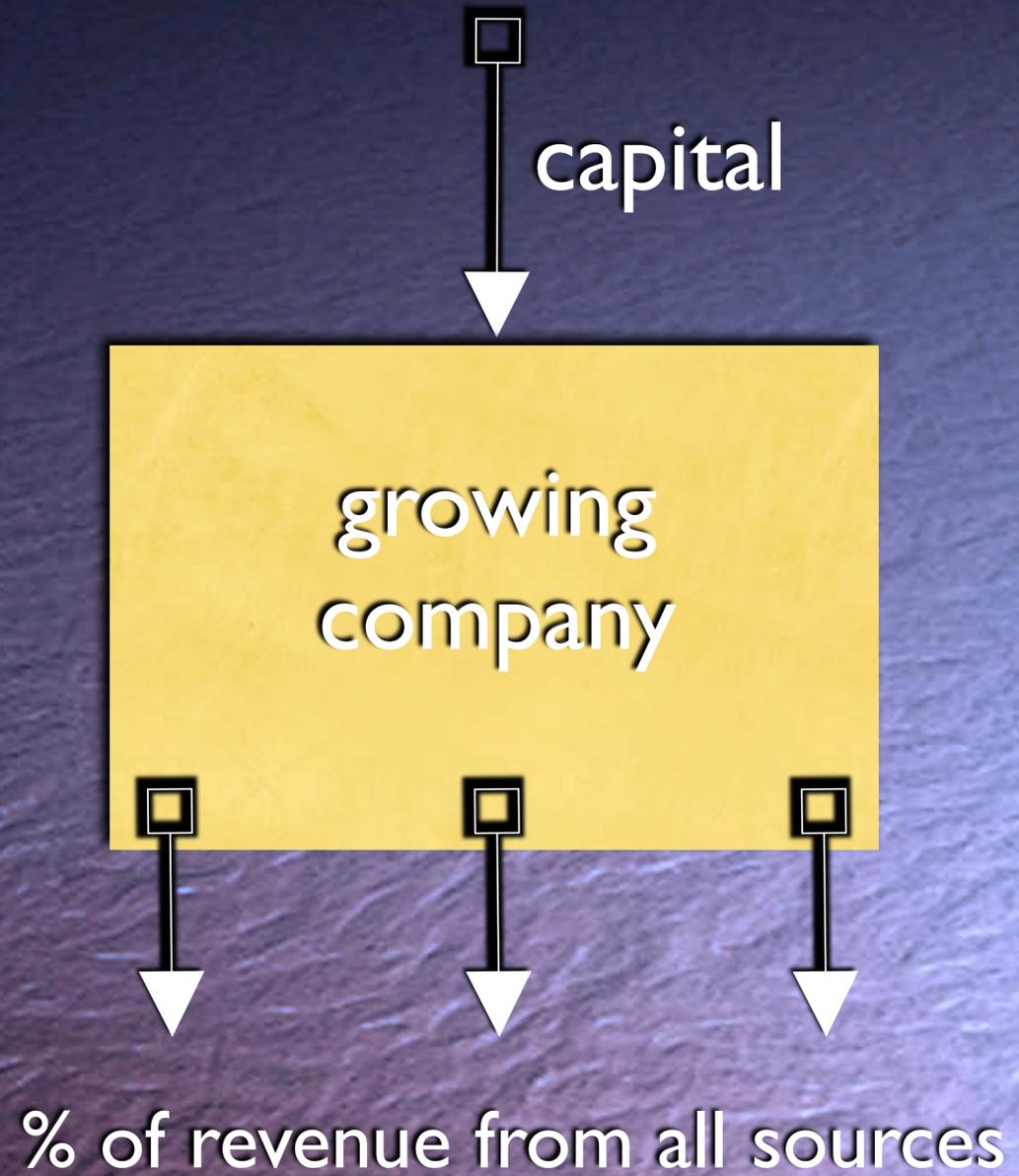


What are Standard Royalties?

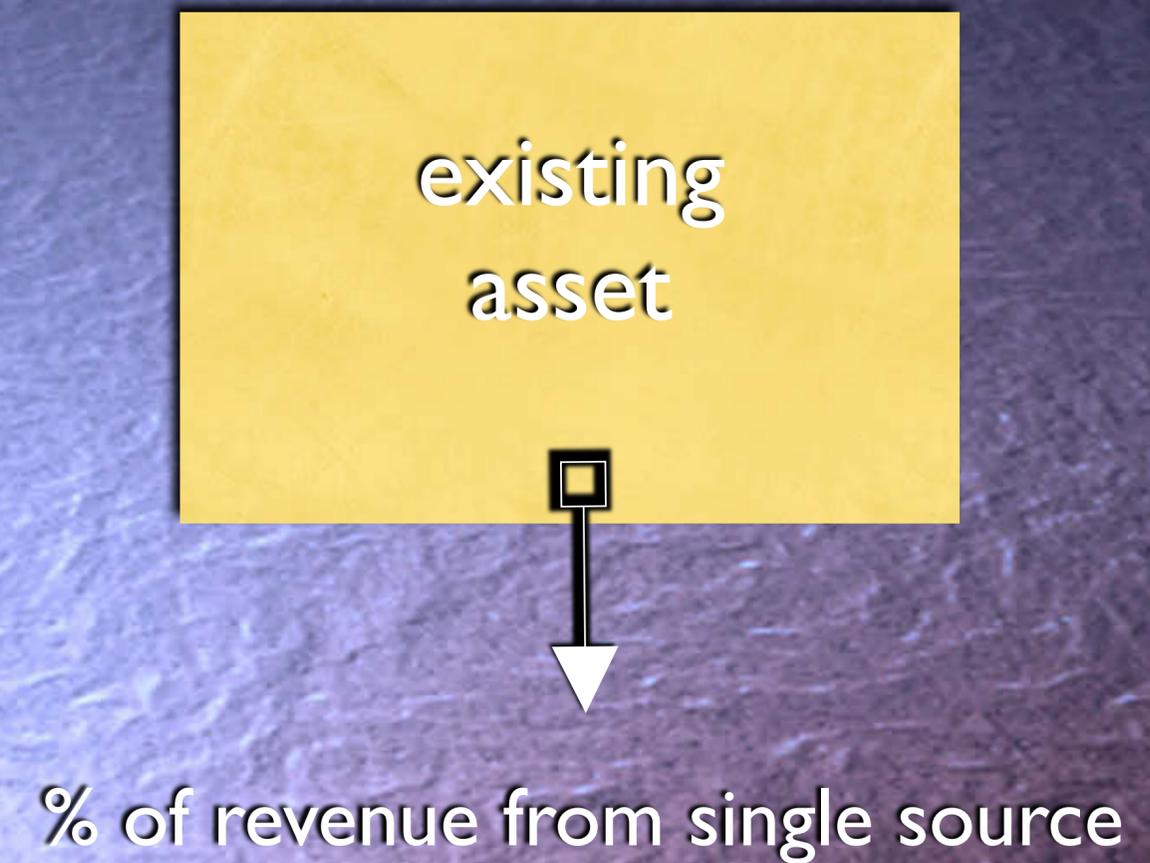
- Other types of royalties:
- a percentage of revenues from existing assets in extractive industries, such as:
 - oil and gas, mining, farming, forestry, fishing
 - use of intellectual property -- theatre, films, books, websites, images, trademarks, patents



revenue royalties

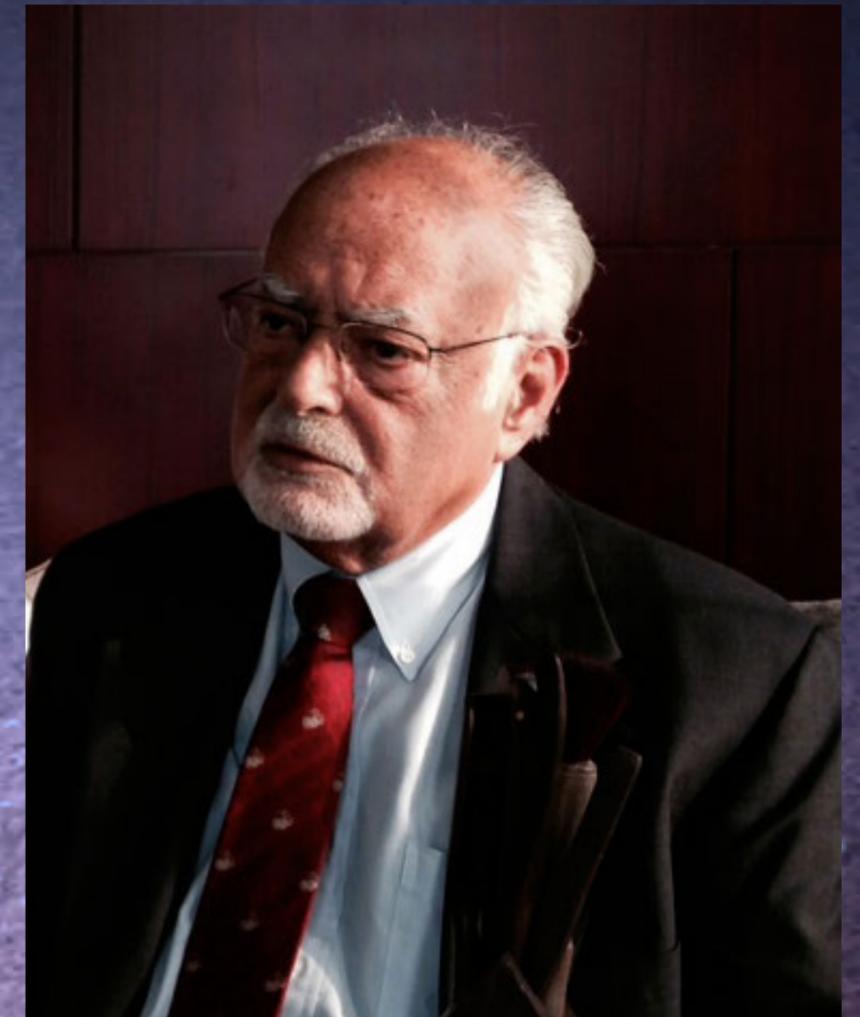


standard royalties



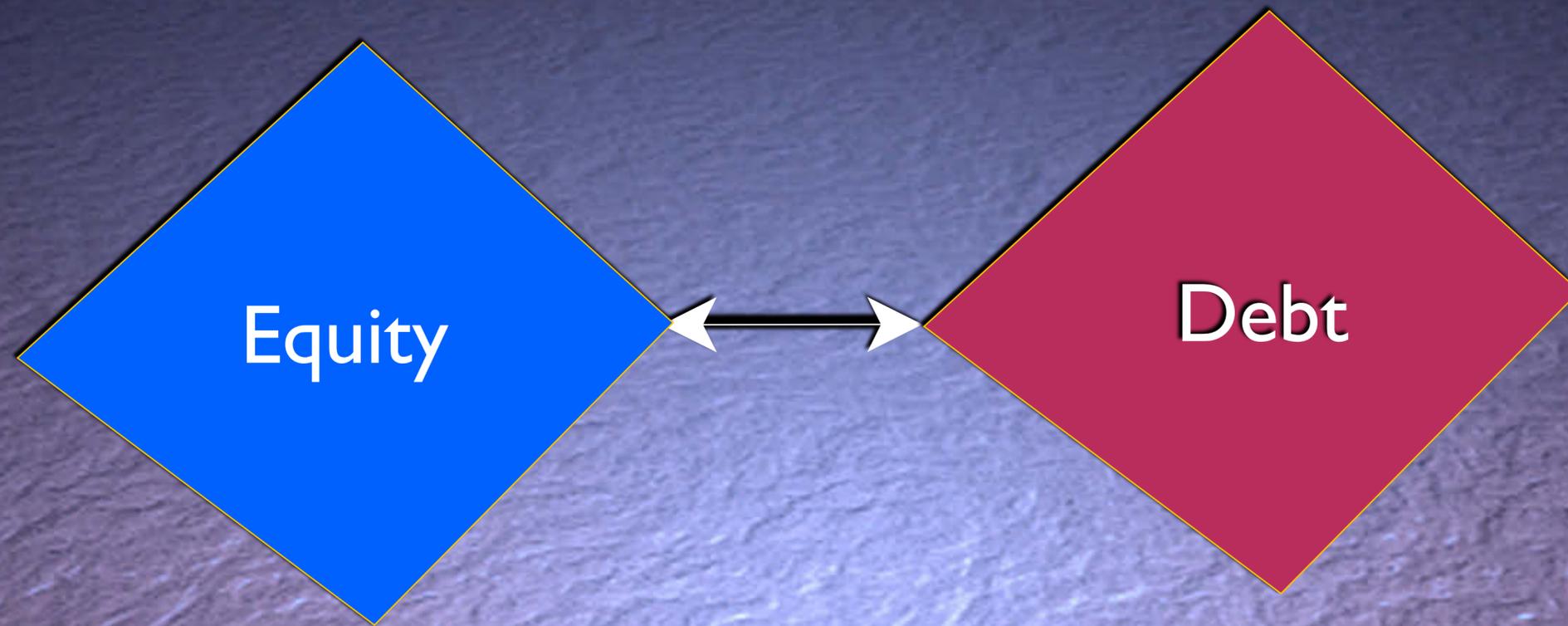
Developed by Arthur Lipper

- financial inventor, chairman of two NYSE institutional brokerage firms, over 60 years
- developed mutual fund analysis; Lipper Index
- author, publisher, teacher, venture capital, angel investor, corporate advisor, philanthropist
- leader of APG design team, China Royalties



Equity and Debt

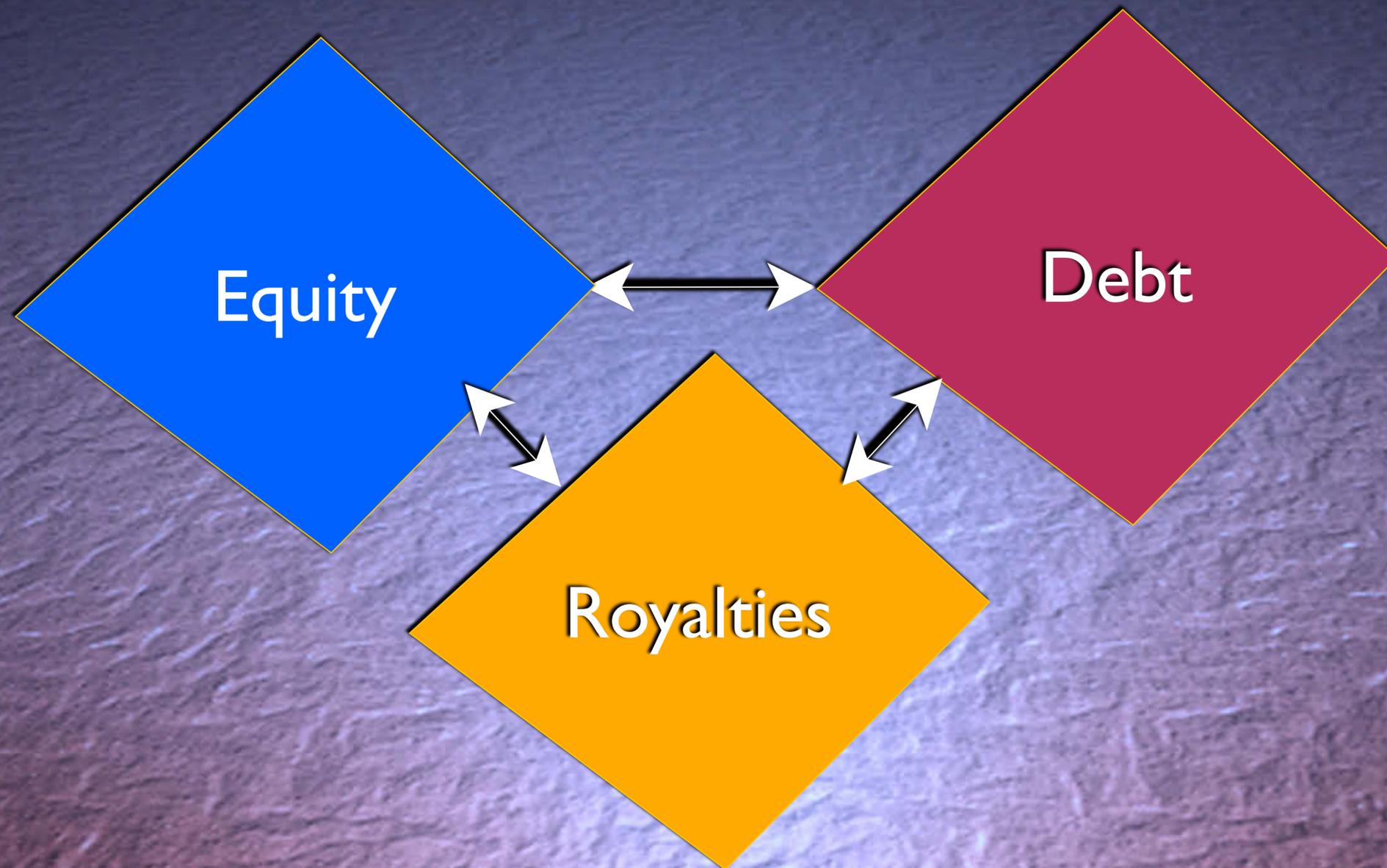
the two poles of today's financial world



equity, stocks, bonds, loans, futures, options, derivatives, currencies

Equity, Debt and Royalties

a more stable ecology



Investment Characteristics

Equity

objective is ownership,
possible influence or control

only exit is to sell, conditional
upon profit achievement,
market perception and
volatility



Investment Characteristics

Debt

concerned with
repayment; may exert negative
control over borrower to
reduce risk of default

fixed minimum return,
through maturity



Investment Characteristics

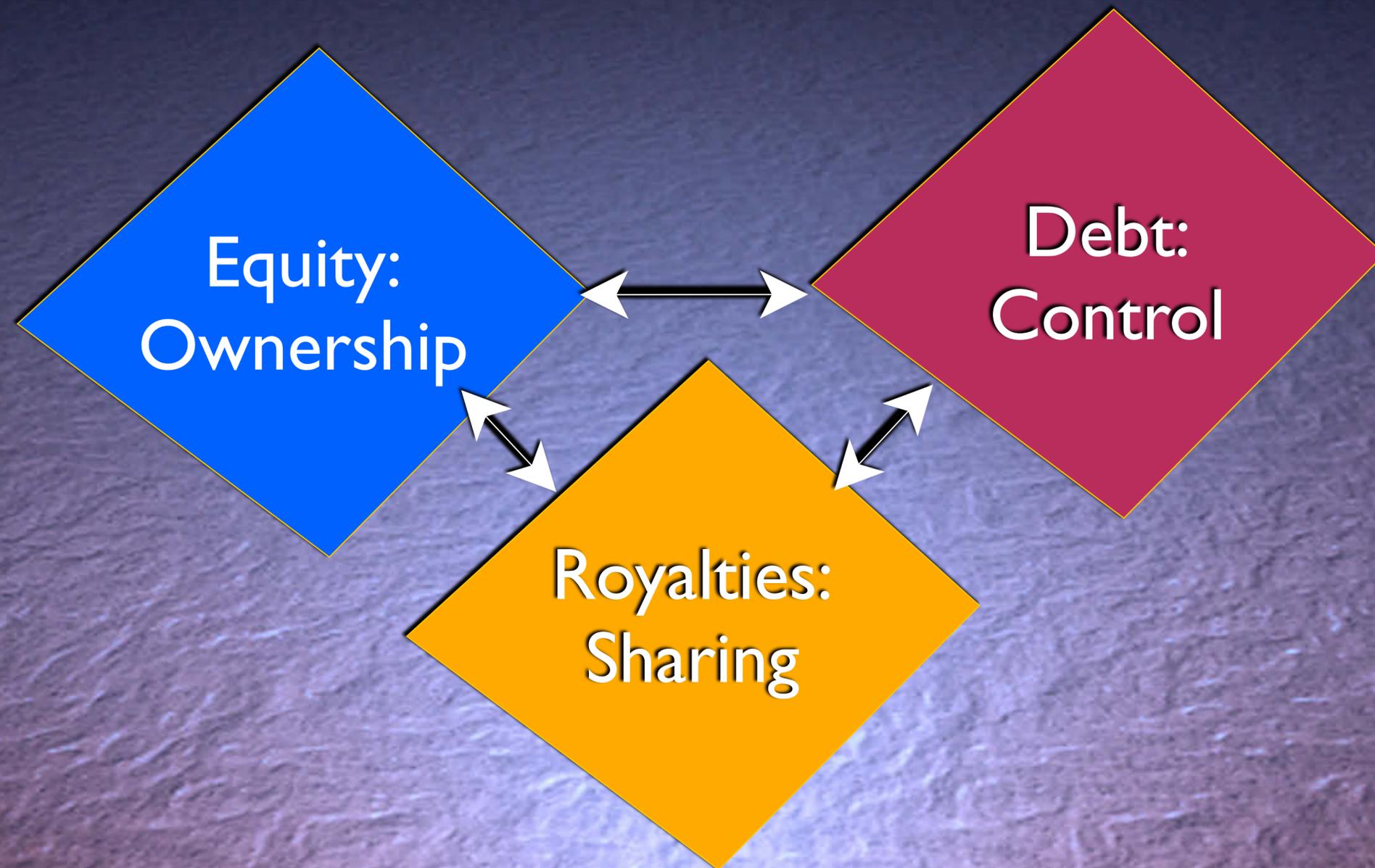
Royalties

objective is long-term
increasing return

immediate payments,
investor protection



Summary: the Ecology of Equity, Debt and Royalties



Variations of Royalties

- changing royalty rates through varying time periods
- combining elements of traditional debt and/or equity
- incentives for exceeding projected results, penalties for missing projections; encourages conservative projections
- combination of single royalty issues into managed funds



Variations of Royalties

- planning early termination redemption rights, by both issuer and investors
- aggregation of single royalty issues into managed, diversified funds with industry, geography, strategy focus
- US Patent: method for collecting agreed payments immediately upon receipt of revenue
- US Patent: method for securing royalties with intellectual property, critical company information



Questions, Discussion



Origins, History



- Equity and Debt: traditional methods of international capitalism, for 500 years
- Emphasis: control of companies, resources and territory by investors
- With near-term profitability as sole measure of success

Drawbacks of Equity/Debt



- Equity: provides potential for great success while opening possibility of total failure
- Debt: creates fixed obligation of debtors to lenders, creates dependency, limits returns

First Examples of Royalties:



- Royalties are a method of financial compensation used by many traditional economies, over 2500 years
- First seen in Mediterranean; wine, olive oil, 600 BCE
- Captain delivers goods safely, is paid on delivery; based on results

First Examples of Royalties:

- First seen in China, 2000 years ago, Han Dynasty
- Associated with adoption of Confucianism by the State
- Used for village enterprise financing
- Used for Silk Road trade finance, in the Marco Polo era





Roman Empire, Imperial China and the Silk Road:
the most durable, profitable economic trade route in history

One of the Oldest Companies

- Established the first share capital company in England
- Granted by King Charles II in 1670
- Hudson's Bay Company: for trade in natural resources of North America
- Now a major public company, approaching 350th anniversary in 2020



A Record of Consistency

- HBC once “owned” 15% of North America, largest landholder in the world
- “Royalties” paid to the King in exchange for land grant, capital
- Trading symbol: HBC (TSX); still remits royalties every 90 days to shareholders
- <http://www.hbc.com>; \$8 billion assets, \$5.5 billion annual revenues

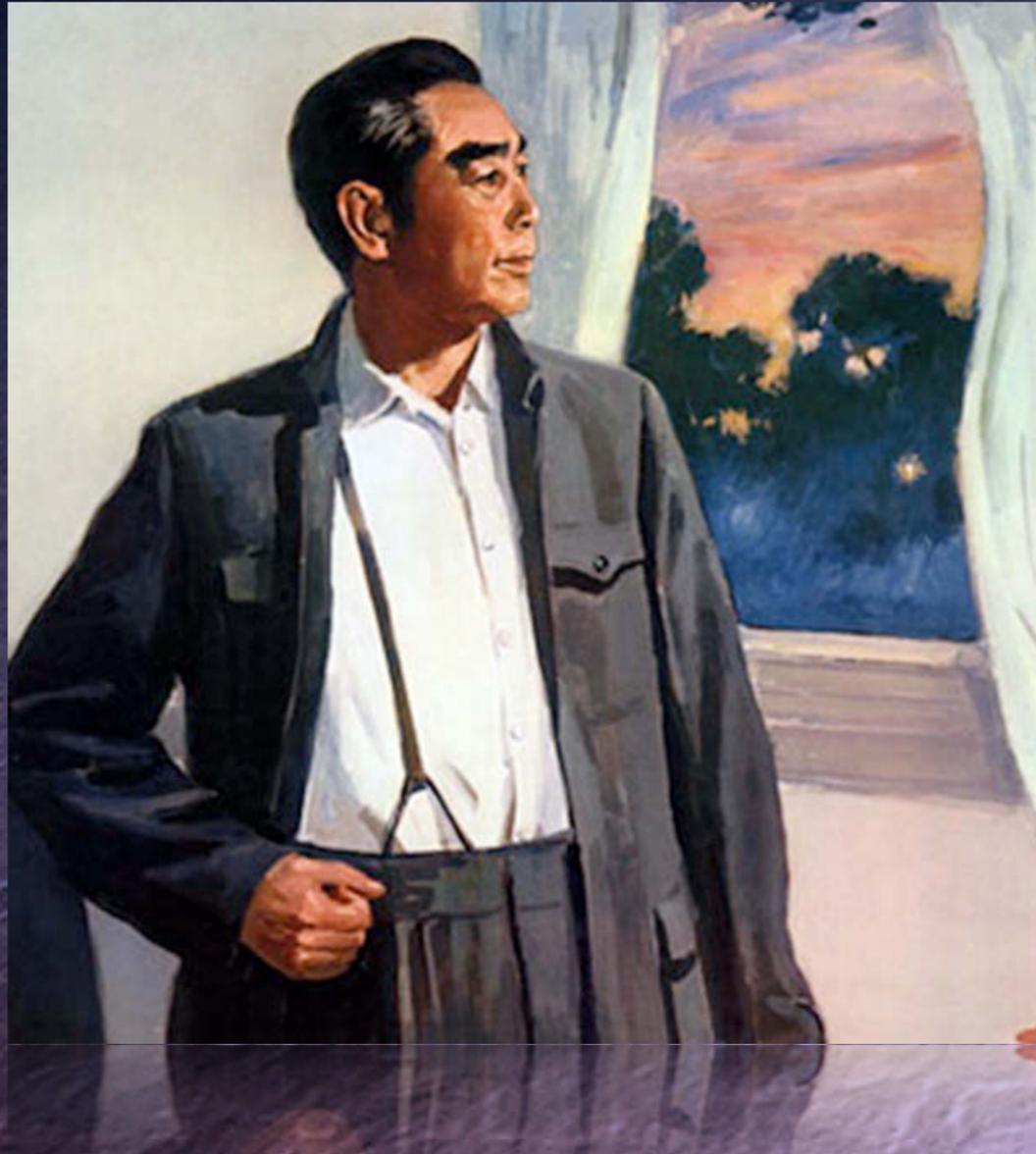


Global Brand Names



owned and operated by HBC

Social Capital Economics



- Royalties consistent with principles of social capitalism, pioneered in China
- Allows balanced participation in success, with lower risk of failure
- Means recalibration of mechanisms for risk and reward

Benefits of PPP Royalties in China



- Reducing dependence and growth rate of public debt
- Making more and larger projects economically feasible
- Providing methods for restructuring existing public debt
- Providing higher returns for conservative investors

Benefits of PPP Royalties in China



- Improving public trust and understanding of financial markets through transparency, simplicity of royalties
- Reducing dangers of bubbles and crashes
- Encouraging long-term emphasis on real productivity

Benefits of PPP Royalties in China



- Improving government credit ratings
- Enhancing profitability of participating financial institutions
- Diversifying risk profile: royalties have low correlation to existing securities and currency markets

Benefits of Private Sector Royalties



- Better access to capital for growing companies: high-income employment, with new capital sources, innovation, opportunities for youth
- Transforming economy from industrial-agricultural roots to knowledge-service-finance future
- Moving toward recognition of RMB as an international currency standard for financing growth

Benefits of Private Sector Royalties

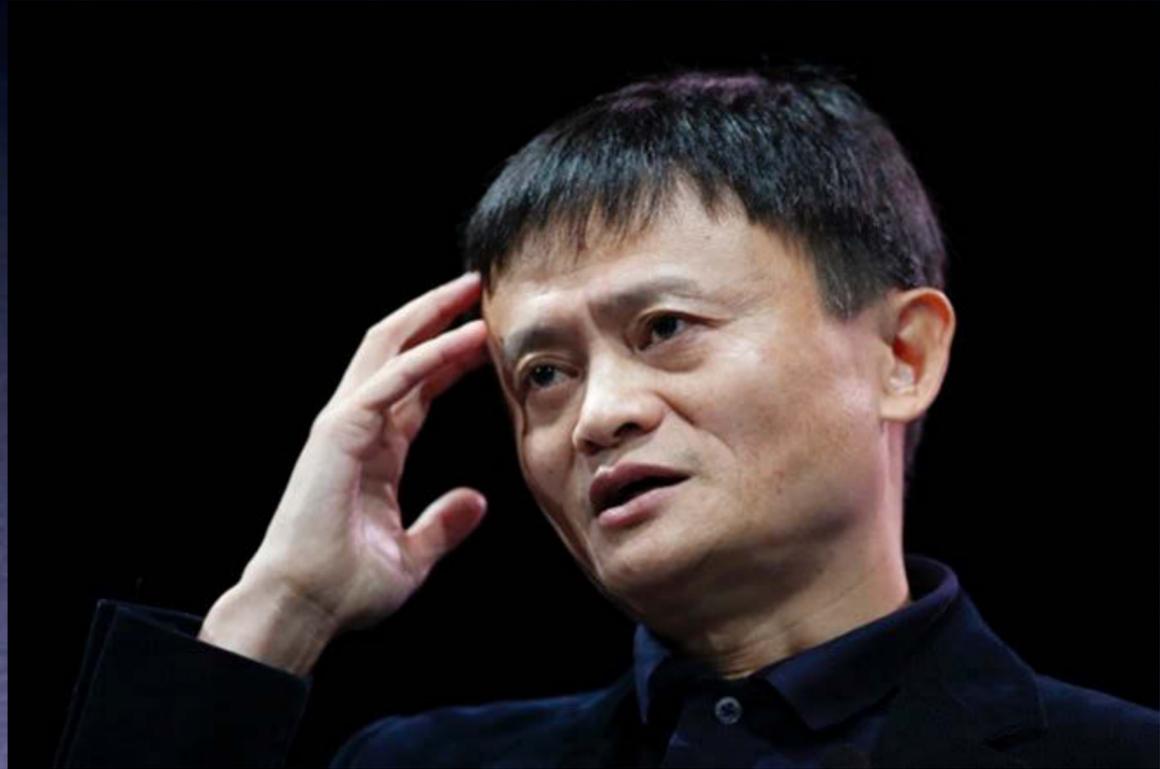


- Freeing up passive capital resources for growth; savings of millions of China's families
- Reducing need for shadow debt markets, high interest rates
- Discouraging short-term speculation, fast turnaround psychology

Private Sector Royalties



- Re-affirming China's leadership in world financial markets
- Training people, government and companies to invest for long-term future, 20 years +
- Using the best expertise of America, shared with China for continuing common prosperity and peace



Challenges to Implementation



- Education of financial community, about a new asset class
- Methods to ensure thorough and honest reporting of all revenues
- Hard contractual methods, soft motivational methods
- Regulatory understanding and approval; NDRC, CSRC, PBOC

Challenges to Implementation



- Determining correct compensation methods for financial institutions
- Implement appropriate treatment of income for tax purposes
- Interaction of VAT, Corporate tax, property tax
- Define correct accounting practices and securities regulations

Challenges to Implementation



- Create a financial product design needed to attract international capital into China
- Resolve currency, liquidity issues
- Harmonize with green, tech, environment, “ecological civilization”
- Consistent with One-Belt, One Road; ready for international implementation after successful China program



One Belt, One Road
finance, trade, culture, technology across all continents

Vision

a refreshed economic revolution
true to the original spirit of China,
based on community,
shared commitment,
equality for all,
lifting up all people,
dedicated to peace.

